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In the Matter of Applications of )  
WorldCom, Inc. for Transfers )  
of Control of MCI Communications )  
Corporation )

CC Docket No. 97-211

PETITION FOR CONDITIONAL APPROVAL OF THE APPLICATIONS OF  
WORLD COM, INC. FOR TRANSFERS OF CONTROL OF MCI  
COMMUNICATIONS CORPORATION

BELLSOUTH CORPORATION

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## TABLE OF CONTENTS

|   |    |
|---|----|
| Summary-----  | i  |
| I. Introduction-----  | 1  |
| II. Legal Standard For Public Interest Evaluation -----   | 2  |
| III. The Acquisition -----  | 4  |
| A. WorldCom -----   | 4  |
| B. MCI-----   | 5  |
| C. The Deal -----   | 6  |
| IV. Long Distance Market Is Highly Concentrated And Not Performing Competitively ---  | 7  |
| A. The Long Distance Market Is Highly Concentrated Under The Merger Guidelines  | 8  |
| 1. Industry Concentration -----   | 8  |
| 2. Increase In Concentration -----  | 11 |
| B. The Long Distance Market Is Prone To Collusion-----  | 12 |
| C. Other Indicators Show That The Long Distance Market Does Not Perform<br>Competitively, Particularly For Residential Customers -----                        | 12 |
| V. Regulatory Barriers To BOC Long Distance Competition Mean That WorldCom's<br>MCI Acquisition Will Harm Competition And Consumers -----                     | 14 |
| A. The Merger Guidelines Predict That Harm To Competition And Consumers Is<br>Likely From WorldCom's Acquisition Of MCI-----                                  | 15 |
| 1. Without BOC Entry, Wholesale Long Distance Prices Will Increase As A<br>Result of The Acquisition -----  | 16 |
| 2. Without BOC Entry, WorldCom/MCI Will Redline The Residential Market,<br>Facilitating Collusion And Bringing Higher Prices To Residential<br>Consumers----- | 16 |
| VI. The Proposed Acquisition Threatens Anticompetitive Harm In The Provision Of<br>Internet Transport-----  | 19 |

|  |    |
|--|----|
| VII. Broad Scale BOC Entry Without Regulatory Handicaps Would Alleviate The Anticompetitive Effects Of The Acquisition -----                 | 20 |
| A. Current Regulatory Interpretation Of Section 271 Have Barricaded The Door Congress Opened To BOC Entry Into Long Distance-----            | 21 |
| B. BOC Entry Into Long Distance, Without Artificial Regulatory Handicaps Would Alleviate The Anticompetitive Effects Of The Acquisition----- | 22 |
| Conclusion-----  | 24 |

## **SUMMARY**

Given the current regulatory barriers to Bell company entry into long distance competition, WorldCom's proposed acquisition of MCI runs counter to the public interest. If consummated, that acquisition will result in substantial increases in overall market concentration, and will lead to huge increases in concentration in the residential market. The proposed acquisition thus threatens consumer harm throughout the long distance business, with the gravest threat to residential customers. Past Commission merger analysis and the DOJ Merger Guidelines support these conclusions. The fact that the stock market has run up prices of the all the facilities-based long distance providers shows that investors and analysts are also forecasting that the proposed acquisition will benefit long distance providers at the expense of their customers.

The public interest remedy for the acquisition is simple: let new competition into the market. By removing the artificial regulatory barriers to Bell company entry into the long distance business, powerful new pro-consumer forces will be unleashed that can counteract the effect of WorldCom's proposed acquisition. Thus, approval of WorldCom's acquisition of MCI must be conditioned on the presence of sufficient Bell company entry into the long distance market in order to protect the public interest.

## I. INTRODUCTION

The Telecommunications Act recognizes the benefits that open markets can bring to consumers. One consequence of the Act's passage will be corporate realignments to reflect changing markets. To the extent WorldCom's proposed acquisition of MCI<sup>1</sup> reflects the demands of open markets for new services and more efficient delivery, it can be beneficial. However, a key aspect of the proposed acquisition is aimed at exploiting the still closed door to Bell Operating Company ("BOC") competition in the long distance market. Thus, to a large extent, the deal poses a real threat to long distance competition and consumers because the long distance market, including providing long distance Internet transport services, remains artificially barricaded to competition from key players, contrary to Congress's market opening goal.

Today, the long distance market is highly concentrated and not performing competitively. The DOJ Merger Guidelines predict that should this acquisition take place, it will result in increased harm to long distance consumers by creating market power and the ability to exercise it anticompetitively. The astronomical premium WorldCom is paying for MCI suggests that this prediction that the deal will create Anticompetitive power leading to unjustified price increases is accurate. The combination of two of the nation's four long distance networks spells higher prices for wholesale services. On the retail side, WorldCom's single-minded focus on the business market means that residential

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<sup>1</sup> *Applications of WorldCom, Inc. for Transfers of Control of MCI Communications Corp.*, CC Dkt. No. 97-211 (dated October 1, 1997)(*"Application"*).

consumers are especially likely to be harmed as the acquisition makes the coordination of the current IXC lock-step consumer price increases easier to continue.

WorldCom's acquisition of MCI also raises significant concerns in the provision of Internet transport services. WorldCom's UUNet Technologies is easily the largest Internet Service Provider. MCI is number two. Allowing a combination of these two firms raises the prospects of creating additional market power and anticompetitive harm.

The current regulatory bar on BOC entry into the competitive fray permits WorldCom to exploit the anticompetitive potential of the MCI acquisition to the fullest. Full-fledged BOC entry into the market would thwart the exercise of that potential as BOCs bring powerful new pro-consumer competitive forces to the market. However, the current regulatory interpretation of the Act's provisions governing BOC long distance entry suggest no clear path or timeline to that entry. Given this regulatory fact, any assumption that BOC entry can occur in time to protect consumers from the anticompetitive fallout of WorldCom's acquisition is sheer speculation. Allowing WorldCom to acquire MCI without conditioning consummation of the acquisition on the presence of sufficiently broad BOC competition in the long distance market to protect consumers would violate the public interest standard.

## **II. LEGAL STANDARD FOR PUBLIC INTEREST EVALUATION**

WorldCom and MCI seek Commission authority to transfer various certificates, licenses and authorizations currently held by MCI to WorldCom. The Commission must review this application under various statutes to determine whether the transfers serve the

“public interest convenience and necessity.”<sup>2</sup> The Commission may attach conditions to such grants of authority as the public interest requires.<sup>3</sup>

WorldCom and MCI bear the burden of proving that WorldCom’s acquisition of MCI will benefit the public interest.<sup>4</sup>

[WorldCom and MCI] must demonstrate not only the efficiency benefits of the merger, but how the merger would enhance or not retard competition. Failure to carry the burden of proof means the Commission must deny the applications or designate them for hearing.

Memorandum Opinion and Order, *Applications of NYNEX Corporation and Bell Atlantic Corporation For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, File No. NSD-L-96-10 (rel. Aug. 14, 1997) (*Bell Atlantic Order*) at ¶ 36.

The Commission has interpreted the “public interest” standard “to secure for the public the broad aims of the Communications Act.”<sup>5</sup> The public interest examination includes whether the transaction furthers Commission policies encouraging competition, as well as its effects on preserving and enhancing universal service and accelerating private sector deployment of advanced telecommunications and information technologies and services.<sup>6</sup> The Commission has taken the position that an acquisition must “enhance

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<sup>2</sup> See, e.g., 47 U.S.C. §§ 214(a), 310(d)(1997).

<sup>3</sup> See, e.g., 47 U.S.C. §§ 214(c), 303(r)(1997).

<sup>4</sup> See, e.g., 47 U.S.C. § 309(e)(1997).

<sup>5</sup> *Western Union Division, Commercial Telegrapher’s Union, A.F. of L. v. United States*, 87 F. Supp. 324, 335 (D.D.C. 1949), *aff’d*, 338 U.S. 864 (1949).

<sup>6</sup> *Bell Atlantic Order* at ¶ 2

competition” for it to be in the public interest.<sup>7</sup> When analyzing potential competitive effects,

Commission analysis of the effect of the transfer on competition is informed by antitrust principles, but not limited by the antitrust laws. The public interest standard, and the competitive analysis conducted thereunder, are necessarily broader than the standard applied to ascertain violations of the antitrust laws.

*Bell Atlantic Order* at ¶ 32. Parties seeking to justify an acquisition because it creates efficiencies must demonstrate that those efficiencies are created by and attainable only through the proposed acquisition.<sup>8</sup> They must also quantify those merger-specific savings and demonstrate that they outweigh any potential anticompetitive harm.<sup>9</sup>

### **III. THE ACQUISITION**

#### **A. WorldCom**

WorldCom is a Fortune 500 provider of global telecommunications services. Its annual revenue is approximately \$6 billion dollars. Through a series of acquisitions, WorldCom now controls a nationwide long distance network, 86 fiber optic local networks and switching facilities in the U.S., and has become the largest Internet Service Provider in the U.S. It is the fourth largest U.S. long distance carrier.

WorldCom’s strategy is to serve lucrative business customers by providing bundled offerings of local, long distance and Internet services. “Our objective is to be the most profitable, single-source provider of communications services to business around the world.” WorldCom Presentation to Analysts, June 16, 1997 (“WorldCom Presentation”)

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<sup>7</sup> *Bell Atlantic Order* at ¶ 2.

<sup>8</sup> *Bell Atlantic Order* at p. 27.

<sup>9</sup> *Bell Atlantic Order* at p. 83.



(emphasis added).<sup>10</sup> Thus, WorldCom's "focus [is] on the business markets," WorldCom Presentation, and the company's goal is "to meet the changing needs of the business marketplace." WorldComm 1996 Annual Report at 6. In its *Application*, WorldCom notes that it has "a special focus on developing state-of-the-art business services." *Application* at 30. Although WorldCom lays claim to over 500,000 business customers, it lays no similar claim to residential customers.<sup>11</sup>

Aside from its single-minded focus on the lucrative business customer, WorldCom has identified its other key advantage as being able to offer end-to-end service over its own facilities. Thus, WorldCom touts its "end-to-end facilities for major business centers" combining local, long distance and Internet services in a single offering. WorldCom Presentation. WorldCom claims that the acquisition of MCI will position the combined company to be a "preeminent provider of advanced one-stop-shopping telecommunications services." *Application* at 2.

WorldCom claims that an MCI acquisition would yield efficiencies that can be realized from providing end-to-end services, however, each company provides end-to-end services independently today. The companies also assert that there are "substantial synergies" from combining local and long distance networks stemming from more efficient network utilization. *Application* at 30.

## **B. MCI**

MCI is a global telecommunications company with 1996 revenues in excess of \$18 billion. It is the number two U.S. long distance carrier, and the world's third largest

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<sup>10</sup> Available at [www.wcom.com/investor/investor.html](http://www.wcom.com/investor/investor.html).

<sup>11</sup> See, "About the Company," <http://www.wcom.com/aboutwc.html>

carrier of international voice traffic. MCI provides service directly to both businesses and consumers over its nation-wide long distance network. MCI has focused on the residential market for many years and has millions of residential customers.

### **C. The Deal**

WorldCom's \$37 billion bid for MCI makes this the largest corporate acquisition ever. That bid raised WorldCom's initial offer by \$7 billion dollars, and exceeded the next highest bid by approximately \$10 billion. On a per share basis, WorldCom's offer is nearly double the price at which MCI shares had been trading two weeks prior to the offer. The astronomical premium WorldCom has volunteered to pay, and the stock market's reaction to it provides some insight into the potential the deal has to benefit WorldCom at the expense of competition and consumers.

During the three trading days immediately following WorldCom's initial \$30 billion offer on October 1, stock prices of British Telecom, MCI, and WorldCom all rose in response to the news by 14 percent, 23 percent and 8 percent, respectively. All totaled, the prospects of moving control of MCI from British Telecom to WorldCom immediately increased the combined market value of all three companies by 13 percent, or \$12 billion. This sudden increase in shareholder wealth coincided with and was no doubt influenced by press reports that WorldCom would "spin off" MCI's 20 million plus residential long distance customers once the acquisition is completed. According to at least one report, WorldCom executives and Wall Street securities analysts do not believe MCI's residential customer base is currently profitable enough to sustain WorldCom's current lofty market valuation of 100 times this year's earnings. And since keeping WorldCom's share price at

or above \$30 is essential to completing the all stock deal, raising prices and/or jettisoning MCI's residential customers to maintain WorldCom's focus on the business market may be essential to the deal.

The run-up in the stock prices of the facilities-based long distance carriers over the last few months provides further reason to believe that WorldCom's acquisition of MCI bodes well for the carriers at the expense of consumers. Between October 1, when the deal was announced, and December 31, 1997, the market weighted average price per share of AT&T, Sprint, MCI and WorldCom stocks jumped 30 percent as compared to a 2 percent gain in the S&P 500 and no change in the Dow Jones Industrial Average. While it is difficult to determine how much of the run-up in these carriers' stock prices is due to prospects for the higher long distance prices and earnings that the proposed acquisition portends, that prospect is likely to have had a significant effect.

#### **IV. LONG DISTANCE MARKET IS HIGHLY CONCENTRATED AND NOT PERFORMING COMPETITIVELY**

The Commission generally looks to the analytical framework set out in the Merger Guidelines as a guide to assessing the likely competitive effects of an acquisition.<sup>12</sup> The effects on competition are a driving force behind the Commission's public interest determination. The Merger Guidelines begin analysis by looking at industry structure. The interexchange market is highly concentrated and systematically non-competitive. In the Michigan Order,<sup>13</sup> the Commission repeated its "concern[s] . . . that not all segments

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<sup>12</sup> *Bell Atlantic Order* at p. 24,

<sup>13</sup> Memorandum Opinion and Order, *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in Michigan*, CC Dkt. No. 97-137 (rel. Aug. 19, 1997) ("Michigan Order")

of this market appear to be subject to vigorous competition,” and “about the relative lack of competition among carriers to serve low volume long distance customers.” Michigan Order at ¶ 16. The Department of Justice also recognizes that the long distance market is highly concentrated.<sup>14</sup>

**A. The Long Distance Market Is Highly Concentrated Under The Merger Guidelines**

The DOJ-FTC Joint Merger Guidelines create a framework for predicting the competitive effects of mergers. Those Guidelines explain that markets with Herfindahl-Hirschman Indexes (“HHI”) exceeding 1,800 are considered to be “highly concentrated.” Mergers in highly concentrated markets that increase the HHI by more than 50 points “potentially raise significant competitive concerns” and those that cause increases of more than 100 points “are likely to create or enhance market power or facilitate its exercise.” Merger Guidelines at ¶ 1.51. Given these thresholds, the HHI and increase created by a WorldCom acquisition of MCI are likely to create market power and harm consumers, given the barriers to BOC entry into long distance competition.

**1. Industry Concentration**

Calculating the HHI generally depends on defining appropriate product and geographic markets and measures of market share. WorldCom’s proposed acquisition of MCI involves a number of products, however, one key area of overlap is the provision of

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<sup>14</sup> Evaluation of the Department of Justice, *Application by SBC Communications Inc., Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services in Oklahoma*, CC Dkt. No. 97-121 (FCC filed May 16, 1997) at p.4 (the HHI “for aggregated interLATA services nationwide was approximately 3,272 in 1995, placing it well within the concentrated range”).

long distance service. The Commission has recognized interstate, domestic long distance service as a separate product market.<sup>15</sup> The Commission has further recognized that product markets for telecommunications services can be divided based on demand considerations. Thus, based on discrete consumer group buying patterns, the Commission has recognized separate markets for the provision of service to “(1) residential customers and small businesses; 2) medium-sized businesses; and 3) large businesses/government users.”<sup>16</sup> The Commission has consistently treated the geographic market for the provision of long distance service to be a national one, based on various considerations related to rate averaging and rate integration requirements and the fact that consumer generally face the same competitive alternatives across the country.<sup>17</sup>

Here, regardless of the precise market definition or method of measuring share, the HHI and the increase due to the proposed acquisition exceed the Merger Guidelines thresholds for identifying anticompetitive mergers. Thus, a Commission report calculates an HHI of 2,823 in a broadly defined long distance market including both business and residential service.<sup>18</sup> Given the market shares the report assigns to WorldCom and MCI, 6

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<sup>15</sup> See, *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, Second Report & Order, CC Dkt. No. 96-61, FCC 97-142 (re. April 18, 1997)(“*LEC In-Region Interexchange Order*”) at ¶¶ 16-51.

<sup>16</sup> *Bell Atlantic Order* at ¶ 53.

<sup>17</sup> See, *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 1 Com. Reg. (P&F) 63 (1995)(“*AT&T Non-Dominance Order*”); *LEC In-Region Order* at ¶ 67, n. 181.

<sup>18</sup> Bender and Rangos, *Long Distance Market Shares Second Quarter 1997*, Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, October 1/997 at 11.

percent and 20 percent respectively, the proposed acquisition would yield an HHI increase of about 240 points in this market.

BellSouth has also developed purely *residential* market share numbers and HHIs based on data available from PNR and Associate's 1997 bill harvesting sample. Market shares based on revenues are set out in Appendix A. Using shares based on residential retail revenues, and including all retailers of residential long distance service in the market, whether facilities-based or not, yields a conservative estimate of the market HHI of 3,960.<sup>19</sup> Given a reasonable estimate of WorldCom's residential market share of 3.1%, WorldCom's acquisition of MCI will increase concentration by about 100 points to 4,058.

Given WorldCom's interest in jettisoning MCI's residential customer base, and the economic and financial pressures to do so, perhaps the most accurate way to measure the deal's likely effect on market structure is to examine what will happen when MCI's residential customers are set adrift.<sup>20</sup> One reasonable assumption is that they will end up at the other residential long distance providers in proportion to current market shares. If so, the net effect of the proposed acquisition is that the HHI for the residential market will end up increasing almost 1,700 points, from 3,960 to 5,630. Even should those customers go to Sprint and the "other" small long distance companies, ignoring AT&T, the most conservative assumption, the HHI would increase by over 300 points, to about 4,290.

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<sup>19</sup> Under this approach the revenues of all retailers are included in calculating the size of the market and market shares. As set out in Appendix A, this yields a group of "other" carriers that collectively share about 17% of the market. Because the share of each of these carriers is relatively small, it would have little effect on the HHI, and is therefore not included in this calculation.

<sup>20</sup> The Commission engaged in similar analysis in the *Bell Atlantic Order*, basing its HHI calculations on assumptions about future market shares. *Bell Atlantic Order* at ¶ 142.

Another way to look at market structure here is to examine shares of the four facilities-based national long distance carriers. On the network side, this acquisition combines two of the four national long distance networks. Attributing reseller shares back to the underlying facility-based provider would greatly increase the HHI for the industry and the increase attributable to a WorldCom acquisition of MCI.

Even assuming that facility-based provider market shares were evenly distributed, the most pro-competitive assumption possible concerning industry structure, the Merger Guidelines again predict that market power will be created and competition will be harmed. Thus, under this pro-competitive assumption, the HHI for the market would be 2,500, again well above the highly concentrated threshold.

## **2. Increase In Concentration**

The increase in the HHI from WorldCom's acquisition strongly suggests that the proposed acquisition threatens consumer harm. The HHI increases are generally substantially above the Merger Guidelines 100 point threshold, regardless of the exact measure of market share used. Thus the HHI increases about 240 points based on the broadest market definition including all long distance revenues. It increases about 100 points in the residential market from the initial acquisition of MCI. A more accurate assessment of the affect on the residential market given WorldCom's incentives to exit the residential business shows that the acquisition is likely to increase residential market concentration astronomically -- most likely by about 1,700 points as MCI's residential customer base is divided up among the remaining providers of residential service. Finally,

based on the assumption of equally divided facilities-based provider network shares, the increase in the HHI from combining WorldCom and MCI would be 1,250.

**B. The Long Distance Market Is Prone To Collusion**

Lock-step pricing of residential long distance prices has raised those prices above competitive levels. AT&T, MCI and Sprint, the three major interexchange carriers control the vast majority of the market. They have engaged in cartel-like price coordination over the last several years. AT&T has consistently led price increases closely followed by MCI and Sprint. The chart set out in Appendix B illustrates the tight coordination of pricing among these three competitors, in spite of consistently declining costs.

The Commission recognized this troubling pricing pattern in its *AT&T Non-Dominance Order*:

The record demonstrates that, since 1991, basic schedule rates for domestic residential service have risen approximately sixteen percent (in nominal terms), with much of the increase occurring since January 1, 1994. Moreover, each time AT&T has increased its basic rate, MCI and Sprint have quickly thereafter matched the increase.

Each time that AT&T raised its basic rates, MCI and Sprint quickly matched the increase.

*AT&T Non-Dominance Order* at ¶¶ 81-82.

**C. Other Indicators Show That The Long Distance Market Does Not Perform Competitively, Particularly For Residential Customers**

In a competitive market, entry by new firms and competition by incumbent firms drive prices toward cost. See Appendix C, Affidavit of Professor Richard L. Schmalensee, (“Schmalensee Aff.”) ¶ 9, Paul W. MacAvoy, The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Services 173-74 (1996) (“MacAvoy



Study”). Yet long distance carriers have failed to pass on cost savings to their customers. Access charges constitute nearly half of interexchange carriers’ total costs. Appendix D, Affidavit of Professor Jerry A. Hausman (“Hausman Aff.”) ¶ 30. From January 1990 to July 1996 these charges declined by 27 percent, yielding at least a 13 percent reduction in interexchange carriers’ total costs during that period. *Id.* Yet carriers have raised their prices despite these declines in access charges. *See* Schmalensee Aff. ¶ 9 (9% drop in access charges between 1993 and 1996, while AT&T raises rates 22%); Hausman ¶¶ 28-32. Indeed, they have raised prices despite additional savings from new transmission technologies and lower equipment prices. *Id.*; *see* Schmalensee Aff. ¶ 9; MacAvoy Study at 96. The major carriers have, moreover, raised their discounted rates along with the basic rates off of which discounts are taken. Hausman Aff. ¶ 31; *see* Schmalensee Aff. ¶¶ 11, 16-17 (discounted rates yield “supracompetitive profits”).

Recent flat-rate promotions do not mark a substantial departure from the long-standing pattern of lock-step price increases. Schmalensee Aff. ¶¶ 12-14; Hausman Aff. ¶ 32. AT&T’s flat rate of 15 cents per minute -- higher than its standard evening rate -- does not benefit typical residential callers who place most calls during off-peak hours. Schmalensee Aff. ¶ 13. MCI’s flat rate of 14.5 cents and Sprint’s two-tiered plan of a 25 cent peak rate and 10 cent off-peak rate also provide modest relief at best.<sup>21</sup> The monthly consumer price index for interstate toll calls rose steadily during 1995 and 1996, with only minor declines in early 1997. As Professor Schmalensee points out, “the only reason that

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<sup>21</sup> *See* AT&T Calls MCI Flat Pricing More Than a Coincidence, Newsbytes, Sept. 30, 1996.

many consumers might find the One Rate plan attractive today is that AT&T has substantially raised its basic rates over the last several years.” Schmalensee Aff. ¶ 14.

To the extent that there have been price reductions, they consist simply of passing only a portion of the interexchange carriers’ savings from recent access charge reductions, and were effected only because the Commission required AT&T to share some of its windfall with residential consumers who pay undiscounted basic rates. *See* Hausman Aff. ¶ 32 (noting that none of the access charge savings was passed on to discount customers). In a competitive industry, regulators do not need to strong-arm competitors into passing on cost-savings to consumers. *See* Schmalensee Aff. ¶ 9.

The major carriers themselves concede that they do not compete for the business of the lowest volume callers. *See id.* ¶ 15. They have in the past claimed that these customers are served below cost, but that does not explain why mid-volume callers are denied discounts. *See id.* ¶¶ 15-17. Besides, even if claims of below-cost pricing were true, they would only highlight the need for additional competition to place pressure upon all carriers to lower operational and marketing costs.

**V. REGULATORY BARRIERS TO BOC LONG DISTANCE COMPETITION MEAN THAT WORLDCOM’S PROPOSED MCI ACQUISITION WILL HARM COMPETITION AND CONSUMERS**

The market share data, the Merger Guidelines, the history of cartel-like behavior in the industry, stock market data and the huge premium WorldCom is offering suggest that much of the acquisition’s value comes from creating the ability to exercise market power. WorldCom is likely to exercise that power in various ways that promise substantial harm to competition and consumers. The current market, with its regulator-imposed sky-high

barriers to BOC entry and handicaps on how BOCs can compete should they finally be allowed to enter, holds no competitive antidote to the ill-effects of this acquisition. Finally, in its *Application*, WorldCom has not provided any substantive information describing efficiencies that can be realized only through the acquisition, or quantifying those efficiencies. Thus, WorldCom has not even attempted to carry its burden of demonstrating any pro-competitive aspects of the acquisition.

**A. The Merger Guidelines Predict That Harm To Competition And Consumers Is Likely From WorldCom's Acquisition Of MCI**

Based on the HHIs calculated above, the government's Merger Guidelines predict that this acquisition is "likely to create or enhance market power or facilitate its exercise" to the detriment of consumers. Merger Guidelines at ¶ 1.51. In evaluating the transfer of NYNEX licenses to Bell Atlantic, the Commission found that an acquisition that raised the relevant HHI from 3,400 to 3,600 provided strong support for the Commission's conclusion that the acquisition was likely to harm competition and consumers. *Bell Atlantic Order* at ¶ 142

The HHI and increase involved in WorldCom's proposed acquisition of MCI are similar or greater. Anticompetitive harm is especially likely given the barriers to entry from BOC competition and this market's demonstrated history of non-competitive performance.<sup>22</sup> Residential customers are particularly likely to suffer. Allowing further

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<sup>22</sup> The Merger Guidelines note that where coordinated interaction among firms, like that between AT&T, MCI and Sprint, has occurred, the market involved is likely to be prone to collusion. Merger Guidelines at ¶ 2.1. A merger between firms in such a market is particularly likely to threaten consumer harm.

consolidation among the network providers of long distance service is thus particularly likely to harm competition and consumers.

**1. Without BOC Entry, Wholesale Long Distance Prices Will Increase As A Result Of The Acquisition**

The proposed acquisition would combine two of the four nationwide long distance networks. This will lead to higher prices to wholesale purchasers of long distance services. As set out above, there are only four national long distance networks. This acquisition would reduce that to three, a change that the Merger Guidelines predict would injure competition. The Commission recently concluded that a reduction in competitors from five to four was reason for concluding that an acquisition threatened the public interest.<sup>23</sup> Especially, given the history of collusive residential pricing among facilities-based long distance providers, the potential reduction in networks from four to three raises grave competitive concerns across all long distance markets.

**2. Without BOC Entry, WorldCom/MCI Will Redline The Residential Market, Facilitating Collusion And Bringing Higher Prices To Residential Consumers**

The huge premium WorldCom is offering for MCI and WorldCom's focus on the business customer bodes ill for residential long distance consumers. By replacing MCI's market strategy, which today at least accommodates residential subscribers with one that does not, the acquisition will further reduce marketplace pressure to provide competitively priced service to residential customers.

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<sup>23</sup> *Bell Atlantic Order* at ¶ 108.

At present, the residential market is defined by tacit collusion among the three national facilities-based long distance providers, as discussed above. WorldCom's acquiring MCI reduces the number of facilities-based players that could upset this cartel-like pricing arrangement. Thus, for example, WorldCom today provides wholesale service to resellers who may compete with the Big 3 for residential customers. Post-acquisition, WorldCom will have reduced interest in allowing resellers to undercut collusively inflated residential pricing margins given its stake in MCI.<sup>24</sup> In addition, funding the deal premium will require WorldCom to improve residential margins, either by jettisoning residential customers or by raising residential prices.<sup>25</sup> Instead of simply following AT&T price hikes, as MCI and Sprint have done, WorldCom/MCI may now choose to lead. Little objection from the long distance cartel is likely, and consumers will thus see higher prices. Certainly, WorldCom/MCI will have little interest in undercutting continued lock-step pricing. Thus, in the Bell Atlantic Order, the Commission found that the "removal of one of the five most significant market participants substantially increases the likelihood" of collusion.<sup>26</sup> WorldCom's acquisition of MCI would remove one of only four facilities-based players. The acquisition thus changes incentives and market structure in a way that makes continued cartel-like price increases to residential customers all but certain.

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<sup>24</sup> The merger thus transforms WorldCom from a potential maverick that could break-up the Big 3 lock-step pricing practices to a member of the club.

<sup>25</sup> "The one (drawback to the deal) is MCI's residential part of the business, that WorldCom has never wanted and has never been involved in." Cynthia Houlton, Utendahl Capital Partners, quoted in "Merger is no deal for consumers," David Browerman, MSNBC at <http://www.msnbc.com/news/114314.asp#BODY>.

<sup>26</sup> *Bell Atlantic Order* at ¶ 122.

Even worse for consumers would be the effects of the likely scenario that WorldCom jettisons MCI's residential business. Analysts have viewed some sort of spin-off as likely, and WorldCom has made statements to that effect. In fact, the economics of the huge premium WorldCom is paying for MCI, roughly double MCI's stock price during the two weeks prior to the offer, may dictate this result. As MCI's residential customers go to the other residential providers, industry concentration will increase astronomically. Assuming those customers go proportionately to the other long distance residential providers, the HHI will increase by 1,700 points, to 5,630. AT&T's share would increase dramatically. This increase in concentration will lead to continued or strengthened patterns of residential lock-step price increases.

Under these scenarios, the proposed acquisition bodes ill for residential consumers of long distance, but well for providers. The prospect of higher profits as a result of the deal are hardly far-fetched given the state of the residential long-distance market. The fact that those prospects are likely to come true is borne out by the stock market's reaction. Market investors evaluating the long distance landscape since WorldCom announced the deal have run-up the prices of AT&T, MCI, Sprint and WorldCom. Thus, a market-weighted average of their prices jumped 30 percent compared to a 2 percent gain in the S&P 500 between October 1, 1997 and the end of the year. Investors and analysts clearly support the idea that WorldCom's acquiring MCI will result in higher long distance prices and earnings.

Finally, extending WorldCom's exclusive focus on packaging for the business market to MCI will exacerbate the growing disparity between business and residential

networks, to the further detriment of residential consumers. To some extent, WorldCom is responding to the natural market demand for packages of telecommunications service that includes local, long distance and Internet service. The incentive for all potential providers to do this on the residential side has been minimized by regulatory restrictions. BOCs, natural providers of bundled local and long distance to residential customers, are barred from providing long distance services. Incumbent long distance providers have every incentive to maintain this bar against BOC competition by not providing bundled service to residential subscribers. In addition, long distance companies are prohibited by statute from bundling resold BOC local service with their own long distance service until the BOC can enter the long distance market.

The effect of these regulatory obstacles is that the stimulus of market demand for seamless packages of telecommunications services is limited to the business side of the market. This is leading to the creation of a two tiered telecommunications infrastructure. A broadband business network that provides the seamless end-to-end service that WorldCom has set as its goal is emerging now, while the development of a similar residential network is hobbled by regulatory disincentives. WorldCom's acquisition of MCI will accelerate the emergence of the business network while further handicapping the development of a residential counterpart.

## **VI. THE PROPOSED ACQUISITION THREATENS ANTICOMPETITIVE HARM IN THE PROVISION OF INTERNET TRANSPORT**

The threat to competition raised by the proposed combination of WorldCom and MCI to the Internet world is perhaps even greater than the threat to long distance voice communication. WorldCom and MCI are today easily the two largest providers of

Internet transport services. Combining these two providers would give WorldCom/MCI a much larger share than any other provider, and control over much of the Internet backbone. Although precise market share data is difficult to come by, in part because of WorldCom's aggressive track record of acquiring Internet service providers, WorldCom/MCI would hold at least half the market. Thus, the post-acquisition HHI would exceed 2,500, and the acquisition would create a large increase in concentration.

A combined WorldCom/MCI could exercise the power created by joining their networks in a number of ways. For example, as the largest provider, WorldCom has already been particularly aggressive about instituting charges for traffic exchange with smaller service providers. Once WorldCom began charging, other large providers, including MCI and Sprint fell in line, also charging for access. A combined WorldCom/MCI would likely be able to institute additional charges, or raise the charges already in place.

## **VII. BROAD SCALE BOC ENTRY WITHOUT REGULATORY HANDICAPS WOULD ALLEVIATE THE ANTICOMPETITIVE EFFECTS OF THE ACQUISITION**

WorldCom's acquisition threatens substantial harm to consumers because artificial entry barriers would protect a combined WorldCom/MCI from competition from BOCs in both voice and Internet transport services markets and thus would allow a combined WorldCom/MCI to exercise market power. The best fix is simply to condition the consummation of the acquisition on broad scale entry of the BOCs into long distance.



This entry will unleash new competition sufficient to protect consumers from the anticompetitive potential of the WorldCom/MCI combination

Conditioning approval of this proposed acquisition on BOC entry provides the most direct, pro-consumer remedy to the threat to the public interest posed by this acquisition. This remedy is consistent with the deregulatory, market-opening approach that Congress intended the Act to bring to the telecommunications industry. It also ensures that consumers reap the benefits of consolidating local and long-distance networks that WorldCom and MCI identify as substantial. *Application* at 30.

**A. Current Regulatory Interpretation of Section 271 Have Barricaded The Door Congress Opened To BOC Entry Into Long Distance**

The FCC's Oklahoma,<sup>27</sup> Michigan<sup>28</sup> and South Carolina<sup>29</sup> Orders have consistently misinterpreted Congress's provisions concerning the prerequisites to BOC entry into the long distance business. Those misinterpretations have turned Section 271 into a barrier to entry rather than the vehicle for opening the long distance market that Congress intended.<sup>30</sup> Those Orders have protected long distance incumbents and their lock-step

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<sup>27</sup> Memorandum Opinion and Order, *Application by SBC Communications Inc., Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services in Oklahoma*, CC Dkt. No. 97-121 (rel. June 26, 1997).

<sup>28</sup> Memorandum Opinion and Order, *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-Region, InterLATA Services in Michigan*, CC Dkt. No. 97-137 (rel. Aug. 19, 1997).

<sup>29</sup> Memorandum Opinion and Order, *Application of BellSouth Corporation, et al. Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, interLATA Services in South Carolina*, CC Dkt. No. 97-208 (rel. December 25, 1997).

<sup>30</sup> That door may be opening as a result of a recent decision in Texas. See SBC Communications, Inc. v. FCC, Civ. Action No. 7:97-CV-163-X, filed Dec. 31, 1997 (N.D. TX).